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FISCAL IMPACT STATEMENT

LS 7333

BILL NUMBER: SB 312

NOTE PREPARED: Feb 18, 2003

BILL AMENDED: Feb 18, 2003

SUBJECT: Small Business Tax Credits.

FIRST AUTHOR: Sen. Lawson C

FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: The bill provides a state tax credit to a small business equal to: (1) 30% of the depreciable cost of certain property placed in service in a trade or business conducted by the small business when the small business places property in service in Indiana; or (2) 30% of the employee expenses incurred for new employees when the small business adds at least five jobs to the Indiana workforce.

Effective Date: July 1, 2003.

Explanation of State Expenditures: (Revised) *Indiana Department of Commerce (IDOC):* The Small Business Job Creation Credit established by the bill would create additional administrative demands for the IDOC. The IDOC is responsible for certifying small businesses that are eligible for the Job Creation Tax Credit. The IDOC must certify (1) the project resulting in employment of the new employees; (2) the maximum amount and duration of the tax credit; and (3) the minimum number of new employees. The additional administrative responsibilities given the IDOC under the bill presumably could be absorbed given its existing budget and resources. The February 7, 2002, state staffing table indicates that the IDOC has 43 vacant full-time positions, including regional office positions.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the tax credits established under this bill. Also, as a result of these tax credits, the DOR would have to establish requirements for information submissions by taxpayers claiming these tax credits; and also monitor claims for various tax preferences that reduce the tax credits under the bill. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: (Revised) *Small Business Expansion Credit:* The bill establishes an Adjusted Gross Income (AGI) Tax credit for the depreciable cost of certain property acquired on or after July 1, 2003, and placed in service on or after January 1, 2004, in Indiana by a small business. The amount of credits that could potentially be claimed by taxpayers is indeterminable; but could potentially be reduced to the extent that taxpayers are unable to claim other tax credits or deductions they are prohibited from claiming with the Small Business Expansion Credit. The net revenue impact depends on the extent that collections from taxable activities and new employees attributable to the investment in new property is less than or exceeds the amount of credits claimed by small businesses. However, if the investment would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by small businesses.

The bill provides for a nonrefundable AGI Tax credit equal to the lesser of (1) 30% of the depreciable cost of qualified property placed into service in Indiana in a taxable year or (2) \$600,000 in total for all qualified property placed in service in Indiana in a taxable year. The tax credit may be applied to the taxpayer's tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years (20% per year) including the taxable year that the property is placed in service in Indiana. (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 10 subsequent taxable years. The 20% amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is reduced to the extent that the taxpayer uses: (1) another AGI Tax credit for the same property, an investment in the same property, compensation paid to an employee who uses the same property, or a project that involves the same property; or (2) an Enterprise Zone deduction for compensation paid to an employee who uses the property.

Revenue from the AGI Tax on corporations is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.

Eligible Taxpayer: A taxpayer is eligible for the AGI Tax credit if the taxpayer: (1) places *qualified property* in service in Indiana in a trade or business; (2) uses the property in Indiana in a trade or business during the useful life (as determined for calculating depreciation for federal income tax purposes) of the property; and (3) qualifies as a small business in the taxable year in which the property is placed in service in Indiana. A taxpayer is a small business if it is: (1) a sole proprietorship operated by a person; (2) a corporation; or (3) pass through entity that qualifies as a small business concern under federal law and federal Small Business Administration requirements. Under a noncode provision of the bill, a taxpayer is not eligible for the tax credit if the property is acquired before July 1, 2003, or placed in service before January 1, 2004.

Qualified Property: Under the bill, qualified property is: (1) tangible or intangible property for which a deduction for depreciation is allowed for federal income tax purposes or (2) any license, right, or interest in a patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item for which an amortization deduction is allowable for federal income tax purposes. The property qualifies for the tax credit regardless of whether the taxpayer claims the depreciation or amortization deduction, as applicable, for the property for federal income tax purposes. Qualified property must be primarily used in Indiana in a trade or business that does not include the trade or business of renting or leasing property to another person or entity. In addition property is not eligible for the tax credit if: (1) it is acquired from a person or entity having certain federally defined relationships to the taxpayer; (2) the federal depreciation basis for the property in the hands

of the taxpayer is determined in relation to the depreciation basis of the property in the hands of the person or entity from which the property was acquired; or (3) the property is used to substantially replace other property used by the taxpayer or a person or entity having a federally defined relationship to the taxpayer. Under the bill, the following property also is not eligible for the tax credit: (1) property that has been used in any other trade or business in Indiana for at least one year before it is acquired by the taxpayer; (2) licensed motor vehicles, airplanes, or other off-premises transportation equipment; and (3) property that is used in or as part of a private or commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sport facility, hot tub facility, suntan facility, racetrack, retail food and beverage service facility, automobile sales or service facility, other retail facility, residential property, or package liquor store.

Small Business Job Creation Credit: The bill establishes an Adjusted Gross Income (AGI) Tax credit for the out-of-pocket expenses incurred on or after January 1, 2004, by a small business for new (full-time) employees. The amount of credits that could potentially be claimed by taxpayers is indeterminable; but could potentially be reduced to the extent that taxpayers are unable to claim other AGI Tax credits or deductions they are prohibited from claiming with the Job Creation Credit. The net revenue impact depends on the extent that collections from new employees on taxable compensation is less than or exceeds the amount of credits claimed by small businesses. However, if the new employment would have occurred in the absence of the tax credit the net impact would be the total credits claimed by small businesses.

The bill provides for a nonrefundable AGI Tax credit equal to 30% of employee expenses attributable to the lesser of: (1) the number of new employees employed by the taxpayer in each month of the taxable year; or (2) the number of new employees specified by the Indiana Department of Commerce (IDOC) in a new employee certification for the taxpayer. The bill limits the aggregate amount of credits claimed by a taxpayer to the maximum total credit amount certified by the IDOC (see *Explanation of State Expenditures*). Employee expenses that may be claimed for purposes of the credit are: (1) wages and other compensation, including deferred compensation; (2) the employer's share of social security taxes; (3) state and federal unemployment taxes; and (4) premiums and other payments made for pension, health care, disability, or death benefits for the employee or other person insured through the employee.

The tax credit may be applied to the taxpayer's tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years beginning in the taxable year after the year in which IDOC certification was obtained. (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 10 subsequent taxable years. The amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is reduced to the extent that: (1) the taxpayer uses another AGI Tax credit for the same project, property used in the same project, an investment in the same project, or compensation paid to an employee who is employed in the same project or who uses the property that is part of the same project; or (2) the taxpayer uses an Enterprise Zone deduction for compensation paid to an employee who uses the property. The tax credit is also reduced to the extent that the taxpayer employs in the project fewer than the number of new employees specified in the IDOC certification, except if this is the result of a labor dispute or casualty loss.

Revenue from the AGI Tax on corporations is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004,

the fiscal impact would begin in FY 2005.

Eligible Taxpayer: A taxpayer is eligible for the AGI Tax credit if the taxpayer: (1) is an IDOC-certified small business employer of at least five new (full-time) employees; (2) employs at least five new employees in Indiana; and (3) qualifies as a small business in the taxable year in which the taxpayer incurs employee expenses for new employees. A taxpayer is a small business if it is a sole proprietorship operated by a person, corporation, or pass through entity that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) qualifies as a small business concern under federal law and federal Small Business Administration requirements. Employee expenses are not eligible for the tax credit if the individual is employed in the following types of facilities: a private or commercial golf course, country club, massage parlor, tennis club, skating facility, racquet sport facility, hot tub facility, suntan facility, racetrack, retail food and beverage service facility, automobile sales or service facility, other retail facility, residential property, or package liquor store. Under a noncode section, a taxpayer is not eligible for the credit for expenses incurred before December 31, 2003.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Department of Commerce, Department of State Revenue.

Local Agencies Affected:

Information Sources:

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